

UPGRADING ALONG VALUE CHAINS: STRATEGIES FOR POVERTY REDUCTION IN LATIN AMERICA



Trade and Poverty in Latin America

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Key messages

- Barriers to entry are key when designing value chain interventions: they must not be so high as to exclude the poor, but they must be sufficiently high to allow participants to gain meaningfully from engaging in the chain.
- Value chain interventions have overemphasised the role of the poor as producers as the main means of reducing rural poverty. In fact, the poor engage with value chains at all nodes as producers, intermediaries, workers and consumers.
- An analysis of the 'enabling environment', the regulatory structures in which value chains operate, is essential. It is not unusual for the main impediment to poor people engaging with value chains to be the state.

In recent years, Latin America has moved rapidly towards liberalising trade, both regionally and internationally. This has stimulated active debate on the merits of a more open trading regime. Getting lost in this polarised debate, however, is an understanding of the impact of changes in the trade regime on marginalised groups, particularly the rural poor.

This briefing examines how value chain analysis (VCA) can, in a practical way, help the rural poor participate gainfully in local, regional and global trade. It begins by explaining why value chains have emerged as a helpful entry point for discussions on rural poverty. Focusing on Latin America, it then summarises some constraints faced by low-income participants in agriculture, while outlining a framework for how the rural poor can upgrade their position within viable value chains. It concludes by pulling together lessons learnt on using value chain analysis and development effectively as a tool to augment the incomes of poor people in rural areas.

Why value chains?

VCA is more helpful than orthodox theory in explaining why the poor may face barriers to trade and how to overcome these. This is because orthodox trade theory uses a series of empirically questionable assumptions to provide an overarching answer to the wrong question – the link between trade and economic growth, on

the one hand, and poverty reduction, on the other, has never been a central focus of trade theory. It also fails to deliver plausible interventions for policymakers and for practitioners who have more modest goals: how to support an identified target group to access (or to access on better terms) specific viable value chains. Recognising these weaknesses, trade theory is itself being reformulated and, in several important respects, is converging with value chain analysis.

A 'value chain' describes the full range of activities required to bring a product or service from conception, through the different phases of production (involving a combination of physical transformation and the input of various producer services), delivery to final consumers and final disposal after use (Kaplinsky and Morris 2001). They do not exist in the sense of their having a tangible reality: they are simply a framework for trying to understand how the world works.

The approach is rooted in the real world of production and exchange. It focuses much less on overarching theory and unrealistic assumptions and more on a practical approach towards supporting specific target groups to access particular value chains. The methodology and framework are used by researchers, businesspeople and donors, with quite different goals: from increasing commercial profits to improving the competitiveness

Box 1: Benefits of value chain analysis

- Recognises the lack of economic power of target beneficiaries compared with more powerful firms setting the 'rules of the game' in the value chain, and how this constrains their choices.
- Has economic viability and commercial sustainability at its core because of its market focus.
- Is a powerful diagnostic tool that can identify critical issues and blockages for specific target groups – and provides a framework for interventions to change the circumstances of the resource poor.
- Identifies the core rents and barriers to entry that determine who in the value chain benefits from production.
- Is inherently scalable: even if the initial focus of a value chain development exercise is a single producer group or firm, the same logic can be applied to a cluster of firms, a region or a whole country.
- Is relatively value free – beyond a concern with competitiveness and the efficiency of the chain – compared with the baggage and assumptions one has to accept when taking on some other theoretical stances.
- Can provide a policy and restructuring tool to counter both market and state failures.

of localities to reducing poverty. They are used for the simple reason that they help focus attention on the right questions and provide practical answers to them. VCA normally shows the build-up of costs along a specific commodity chain. This can be complemented with an identification of the business service providers and what are considered to be the main determining factors in the external policy environment.

Value chain analysis is well suited to understanding how poor people in rural areas of developing countries can engage, or improve their terms of engagement with, domestic, regional or international trade. Box 1 lists the benefits of this form of analysis, which help to explain why value chain analysis has had such a profound impact on development studies in recent years.

Themes emerging from the COPLA studies

Five studies, commissioned by COPLA in Latin America, examined a range of 'traditional' and 'non-traditional' agricultural commodities: Brazil nuts in Bolivia, bananas in Peru, trout in Peru, wood furniture in Nicaragua and Honduras and rural community-based tourism in Guatemala and Nicaragua. The studies all adopted elements of VCA. They confirm much of what we know already about how the poor engage with trade, and how efforts to link poor producers with international markets through larger producer/exporters may succeed or fail.

Five important themes emerged from the studies:

1. That rural poor almost always forge links with lead firms in order to access international markets.
2. The difficulties of sustaining vertical linkages.
3. Unsustainable interventions (often by external actors), which are insufficiently linked to markets.
4. The importance of the enabling environment in which value chains operate in determining their sustainability and distributional impacts.

5. That poor people engage with value chains at a number of different nodes of the chain, as workers and consumers as well as producers.

Upgrading strategies for the rural poor

Upgrading means acquiring the technological, institutional and market capabilities that allow resource-poor rural communities to improve their competitiveness and move into higher-value activities. In short, upgrading is the process of trading up.

Over the past few years, development studies have been developing a language, approach and experience to support poor people in rural areas to upgrade their position in viable value chains. A 'traditional' upgrading sequence has emerged: that of process upgrading moving into product upgrading and on into functional and inter-chain upgrading. This categorisation is relevant for manufacturing firms in the newly industrialised countries of Southeast Asia seeking global markets, but it needs adjustment if it is to be relevant to the pressing task of upgrading some of the poorest and most disadvantaged, including agricultural producers and exporters, into viable value chains.

The Overseas Development Institute (ODI) has been working with the International Development Research Centre (IDRC) and with action research teams across Africa and Asia for the past three years to explore different ways that the rural poor can engage successfully in viable value chains. On the basis of this practical experience, we propose a menu of seven different upgrading strategies (see Figure 1).

Horizontal coordination is the process of greater intra-nodal organisation, often in the production and processing nodes, in some form of collective structure (typically a producer group). This form of upgrading is very important for poor people in rural areas because

coordination with others allows producers to achieve economies of scale in supplies and to reduce transaction costs. Often, horizontal coordination is the first step in a sequence of interventions that ultimately result in access to the market, and is a prerequisite for other forms of upgrading. Critical to the success of horizontal coordination strategies are the entry rules to join the group and the quality of management of the group structure.

Vertical coordination is the move away from one-off spot transactions towards longer-term inter-nodal relations, for instance contract farming, whereby a processor or exporter will contract horticultural out-grower farmers. This form of upgrading is important because it can result in greater certainty about future revenue flows for poor participants. In practice, vertical coordination is often a slow and difficult process because it involves the building of trust relations between the buyer and the seller (to avoid the common scenario whereby producers break their contractual commitments and sell their produce on the spot market when prices are higher than specified in the contract).

Functional upgrading refers to changing the mix of functions performed by actors in the value chain – increasing (upgrading) or reducing (downgrading) the number of activities performed by individuals and firms. For instance, an agricultural producer starting to process some of their output to add value to it represents functional upgrading. Often, horizontally coordinated institutions are best able to provide these value-adding activities (such as grading and packaging of produce).

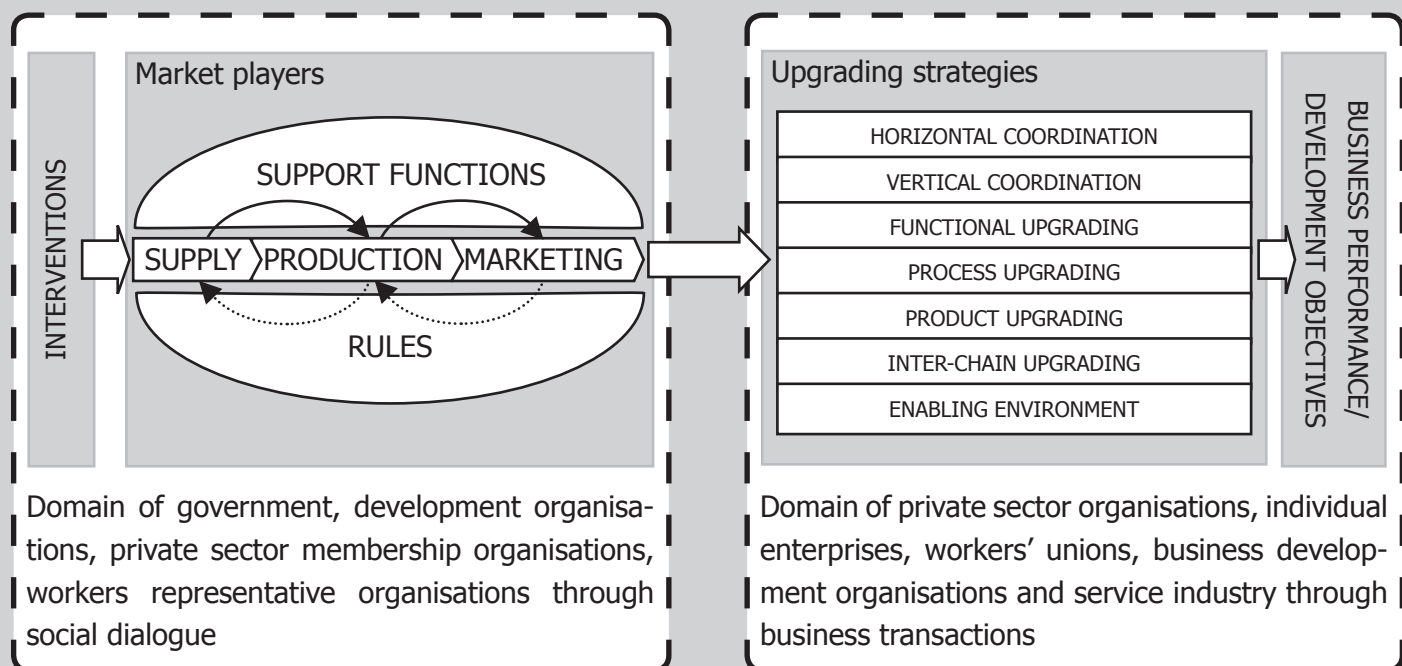
Shortening the value chain can be achieved by excluding intermediaries and redistributing their functions among the partners of a newly formed vertical relationship. It is very rare for the poor to functionally upgrade in the absence of other upgrading strategies.

Process upgrading involves improving value chain efficiency by increasing output volumes or reducing costs for a unit of output. Examples of this include improving agronomy to enhance yields that result in higher sales or own consumption, or both. This may be the result of improved planting techniques, planting materials or investments, such as irrigation infrastructure.

Product upgrading has become increasingly important as the richer economies have become more quality conscious and as standards have risen. Some standards are driven by lead buyers (i.e. supermarkets requiring traceability of food products), others by statutory hygiene standards in importing countries and others, increasingly, in response to fair trade and organic demands by final consumers. The challenge of standards lies in achieving them (to allow market access) without excluding the poor from the value chain. Process and product upgrading are closely related because improving product quality often involves improvements to the production process.

Inter-chain upgrading is the use of skills and experience developed in one value chain to productively engage with another – usually more profitable – value chain. Examples of this include the shift from growing traditional commodities to high-quality export

Figure 1: A new typology of upgrading strategies



Source: Adapted from Herr (2007).

horticulture. Inter-chain upgrading often has significant barriers to entry for the poor and vulnerable to access the more lucrative value chain.

'Upgrading' of the enabling environment, although not an upgrading strategy in a strict sense, recognises that the competitiveness of the enabling environment for value chains is a major contributing factor in the success of the operations of a value chain. Improvements to the support, services, institutional, legal and policy frameworks in which value chains operate are often a productive area in which development agencies can intervene to improve the functioning of a chain.

Valuable lessons

Emerging from our studies are several key lessons for policymakers and practitioners seeking to assist the entry, participation and upgrading of the rural poor in value chains. Beyond taking a broader view of upgrading strategies, we underline the importance of:

- 1. Clarity on the rationale for the (possible) intervention:** In particular, it is important to distinguish whether the primary aim of an intervention is to reduce poverty or to stimulate growth in the local economy. Whatever choices are made regarding the aim of the intervention, it should be accepted that, as with any sustainable private sector development project, the non-poor will necessarily gain from the intervention as well as the resource poor.
- 2. Selecting an appropriate value chain to develop, with suitable demand requirements:** The choice of value chain has important implications for the barriers to entry for the poor and for the sustainability of the initiative.
- 3. Rigour in applying research methods:** Value chain analysis and development requires robust evidence-based research of the current market system and a clear appreciation of which blockages poor people can overcome

and how. Poor-quality research can result in project failure, with disastrous consequences for target beneficiaries.

- 4. Defining appropriate interventions:** It is important that the interventions proposed for value chain development spring from, and are constrained within, the logic of the VCA and the market development approach.
- 5. Identifying the key rents that allow poor producers to participate gainfully and sustainably:** Participation in markets does not, in itself, provide for sustainable income growth. The key goal is to locate rents in the chain that can be captured by poor people and that are unlikely to be eroded through time as a result of competition.
- 6. Understanding about barriers to entry:** The trade-off in developing barriers to entry which are not so high that all the poor are excluded, but which are sufficiently high to allow participants to gain rent, lies at the heart of pro-poor value chain development.
- 7. Avoiding obsessing about the production node in agricultural value chains:** Poor people engage with value chains at all nodes as producers, intermediaries, workers and consumers. It is not necessarily the case that the largest pro-poor impact should centre on the production node.
- 8. Analysing the enabling environment carefully:** A careful analysis of the operation of value chains will often identify state failures as well as market failures. It is not unusual for the main impediment to poor people engaging with value chains to be the state that purports to represent them.
- 9. Taking action:** Upgrading the position of poor people in value chains on a sustainable basis is not easy. It requires the cooperation of many stakeholders in the chain, an inclusive policy process, which must include the lead firms, and a pragmatic and non-ideological approach towards value chain restructuring.

References

Herr, M.L. (2007) *Local Value Chain Development for Decent Work: An Operational Guide*. Geneva: International Labour Office.

Kaplinsky, R. and Morris, M. (2001) *A Handbook for Value Chain Analysis*. Ottawa: International Development Research Centre.

About COPLA

Comercio y Pobreza en Latino América (COPLA, or Trade and Poverty in Latin America) is a two-and-a-half year project that explores the linkages between trade, poverty and social exclusion in Latin America.

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